SUMMARY of COOPERATIVE CASES

FARMER COOPERATIVE SERVICE
U. S. DEPARTMENT OF AGRICULTURE
WASHINGTON, D. C.

SUMMARY NO. 67 MARCH 1956

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The comments on cases reviewed herein represent the personal opinion of the author and not necessarily the official views of the Department of Agriculture.

AMOUNTS WITHHELD IN CAPITAL REVOLVING FUND NOT TAXABLE TO CASH BASIS TAXPAYER IN YEAR CREDITS ARE ESTABLISHED

(Halladay v. U.S., unreported, except C.C.H. 55-2 USTC, Par. 9637)

The conclusion reached by the District Court in this case, although prior in time, is consistent with the decision in Moe v. Earle, 226 F. 2d 583 (See Summary No. 66, p. 1). It is that retains for capital purposes, made by a marketing cooperative from the proceeds derived from the marketing of fruit, are not taxable to a cash basis taxpayer in the year in which such retains are made and noticed to the taxpayer.

During 1949 and 1950, Halladay was a citrus grower in Orange County, California. Since 1938, he had been a member of Placentia Mutual Orange Association, a nonprofit agricultural cooperative association operating under California law. In 1949 and 1950, Halladay delivered fruit to the association pursuant to a Growers Agreement, Bylaws, and Revolving Fund Agreement of the association. The fruit was sold, and the proceeds less expense deductions were paid to Halladay.

Included in the "deductions" was 10 cents per field box as a contribution to capital of the association. The Revolving Fund Agreement contained the usual provisions that the fund could be used by the association as capital and revolved in the discretion of the board. The normal period was 5 years. No certificates were issued but the patron received a receipt showing the amount deducted.

Halladay reported on a cash basis. In 1949 and 1950, he reported redemptions of prior withholdings but did not report the current withholdings. The Commission determined deficiencies based upon this failure to report the current deductions. Halladay paid the deficiency and filed a claim for refund asserting that the current deductions were not reportable or, in the alternative, that if they were reportable then the redemptions of earlier withholdings were not reportable, and he was entitled to a refund of the taxes paid on those amounts.

The claim having been rejected, Halladay sued for a refund. The District Court filed the following conclusions of law:

> "I. The additional tax collected under the deficiency assessments described in Paragraph IX of the Findings of Fact, was a tax on the amount deducted from the proceeds attributable to the sale of Plaintiffs' fruit and was credited to their account in the revolving fund of the Association.

"II. The sums credited to the Plaintiffs' account in the Association revolving fund were for use in future business of the Association and could be lost or expended in such operation and the Plaintiffs had no right to immediately withdraw said sums.

"III. Plaintiffs did not actually or constructively receive any cash or anything of value as a result of the aforesaid deductions by the Association, and such deductions and crediting to their account were not income to them.

"IV. The Plaintiffs are farmers and cash basis Taxpayers and are not required to report the credits to the revolving fund until the cash is actually received by them.

"V. Plaintiffs are entitled to judgment in the sum of $906.42 which is the amount of the deficiency assessments paid by the Plaintiffs for the year 1949 and 1950 plus interest thereon from December 1, 1952, until paid."

CERTIORARI ASKED IN MOE V. EARLE

On January 25, 1956, a petition was filed in the Supreme Court of the United States, requesting that Court to review the decision in Moe v. Earle, 226 F. 2d 583 (See Summary No. 66, p. 1). At press time, the Court had not acted on the request.

APPLICABILITY OF FAIR LABOR STANDARDS ACT TO AGRICULTURAL EMPLOYEES

(Mitchell v. Budd, 221 F. 2d 406)

The United States Supreme Court has granted certiorari in this case to review a decision of the United States Circuit Court of Appeals, Fifth Circuit.

The questions presented on the appeal are these:

1. Are off-the-farm employees of tobacco-bulking plants which either process their own tobacco or that grown by other farmers, employed in "agriculture" within the meaning of section 3(f) of Fair Labor Standards Act, and therefore exempt under section 13(a)(6) from the Act's minimum wage and overtime provisions?

2. Are tobacco-bulking plants' employees engaged in any of the enumerated operations on "agricultural or horticultural commodities" within exemption provided by section 13(a)(1) of the Act?

3. Did the Wage and Hour Administrator's regulation validly define "area of production" pursuant to section 13(a)(10) of the Act?

The Circuit Court had held that:

1. A tobacco company's packing house employees engaged in preparing for market tobacco grown exclusively on company's farm are exempt from Fair Labor Standards Act under section 13(a)(6) as agricultural employees.

2. Employees of a tobacco company processing tobacco raised by other farmers, as well as employees of company processing its own tobacco, are exempt under section 13(a)(10).

3. The Wage and Hour Administrator's regulation defining "area of production" is invalid insofar as it limits such area to "the open country or in a rural community" and excludes "any city, town or urban place of 2500 or greater population."

4. Until the Administrator has validly defined "area of production" under section 13(a)(10), the Secretary of Labor is in no position to seek injunction restraining alleged violations of the Act by tobacco companies which claim their employees are exempt under that section.

BLUE SKY LAW HELD INAPPLICABLE TO SALE OF INTEREST IN COOPERATIVE APARTMENT HOUSE

(State v. Silberberg, (Ohio) 130 N.E. 2d 244)

Defendants were convicted in the Court of Common Pleas (128 N.E. 2d 675) for violating the Ohio Securities law by selling unregistered securities without a license. This decision was reversed on appeal, the Court of Appeals holding that the transaction was not such as to come within the securities law.

The court observed that no hard and fast rule can be established which will clearly divide transactions which constitute a sale of securities from those which are not. It said:

> "If the contracts entered into are bona fide contracts for the sale of real estate to be occupied by the buyer, they are not securities under the Securities Act. If, however, the purpose and intent is not to buy an interest in the land itself, but only to participate in a profit-sharing scheme involving the use of such real estate, it is a security even though it involves the sale of real estate. Form must be disregarded for substance."

The court then said, in part:

> "In speaking of the so-called Blue Sky Law, the Supreme Court of Ohio, in the case of Groby v. State, 109 Ohio St. 543, 143 N.E. 126, 128, states:
>
> > "'This legislation was enacted for the obvious purpose of guarding investors against fraudulent enterprises, to prevent sales of securities based only on schemes purely speculative in character, and to protect the public from swindling peddlers of worthless stocks in mere paper corporations.'
>
> "The evidence in these cases clearly shows the buyers were buying an interest in an apartment building for the sole purpose of occupying the same as a home. That is the clear intent and purpose, as gleaned from the contract. Neither the evidence of the parties involved nor the contract itself shows any plan or scheme to invest in a profit-sharing venture. The buyers were to take possession of and occupy the property described in the contracts. This they have done and were occupying the premises at the time of trial.

"The purpose of an investment in a security is the hope of receiving an income as a return on such investment. There is nothing revealed by the record in these cases that shows such intent or purpose. The provisions in the contract for the formation of a corporation is incidental to the sale of an undivided interest in the real estate. The inclusion of these provisions for the formation of a corporation does not destroy the basic character of the instrument, nor invalidate the right of the purchaser as specifically set out in the contract, to demand a deed for his fractional part of the real estate upon payment of the purchase price. It is true the contract requires the seller to form a corporation, but does not require the buyer to subscribe to the stock or to surrender his deed to a fractional interest in exchange for the stock. The formation of the corporation is plainly a means for operating and maintaining the property as a whole as a cooperative venture. There is evidence in the record that a number of persons who held identical contracts in the same building have completed their payments and received deeds for their fractional interest. The purchasers were buying real estate and not shares in a corporation, and being contracts for the sale of real estate are exempt from registration."

RECENT INTERNAL REVENUE SERVICE RULINGS OF INTEREST TO COOPERATIVES

1. Exemption will not be denied because substantial part of voting stock is held by membership committee as trustees for the members. (Rev. Rul. 56-21; I.R.B. 1956-4, 7)

"A farmers cooperative marketing and purchasing association otherwise exempt from taxation under section 521 of the Internal Revenue Code of 1954, will not be denied such exemption if a substantial part of its voting capital stock is held in trust by its membership committee for members of the association who are the beneficial owners thereof. Capital stock so held qualifies as stock 'owned by producers who market their products or purchase their supplies and equipment through the association' within the intendment of section 521 of the 1954 Code."

2. Transportation tax inapplicable to certain hauling charges paid by farmer member of cooperative. (Rev. Rul. 55-752; I.R.B. 1955-52, 28)

> "A cooperative association organized and operated for the purpose of marketing its members' produce is not a 'person engaged in the business of transporting property for hire,' within the meaning of section 4272(a) of the Internal Revenue Code of 1954, with respect to trucking services furnished by it to its members with its own trucks, where such services are incidental to its business of marketing the members' produce. However, with respect to trucking services furnished to the members which are not performed in connection with the marketing of their produce, the association is a 'person engaged in the business of transporting property for hire.'

"Advice has been requested whether the following-described trucking services furnished by a cooperative association are regarded as transportation of property by a 'person engaged in the business of transporting property for hire' within the meaning of section 4272(a) of the Internal Revenue Code of 1954, so as to determine whether charges made in connection with such services are subject to the tax on transportation of property imposed by section 4271(a) of the Code.

"A cooperative association composed of farmer member patrons was organized under state laws for the purpose of operating a general retail store. The association owns and operates trucks which pick up the members' produce, deliver it to the store, and do such other hauling as is necessary in the conduct of the store's business. The truck drivers are employed by the association. The cost of operating the trucks is deducted pro rata from the members' share of the proceeds.

"In addition to the hauling performed in connection with the operation of the store, the trucks of the association pick up milk from some of its farmer members and deliver it to various creameries designated by the members. The association does not buy, process or sell the milk. A charge is made to the members for such hauling. The net earnings derived by the association from this operation are distributed to the members on a patronage basis.

"Section 4271(a) of the Code imposes a tax upon the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Under the provisions of section 4272(a) of the Code, the tax applies only to amounts paid to a person engaged in the business of transporting property for hire. The tax is payable by the person making the taxable transportation payment and is collectible by the person receiving such payment.

"It is held that the cooperative association in the instant case, which was organized and is being operated for the purpose of marketing its members' produce, is not a 'person engaged in the business of transporting property for hire,' within the meaning of section 4272(a) of the Code, with respect to the trucking services it furnishes to its members with its own trucks, where such services are incidental to its business of marketing the members' produce, and any charges made for such services are not subject to the tax on transportation of property. However, to the extent that the trucking services furnished by the association to its members are not a part of its business of marketing its members' produce and therefore are not considered as being incidental to its business of marketing, it is considered a 'person engaged in the business of transporting property for hire' and any charges made for such trucking services are subject to tax.

"Under the circumstances described, the trucking by the cooperative association of the members' produce to its general retail store is considered to be incidental to its business of marketing such produce, and any charge made to the members, or cost deducted from the profits inuring to the members, for such services are not subject to the transportation tax. However, since the trucking by the cooperative association of its members' milk to creameries is not a part of its business of operating the retail store, such trucking is not considered incidental to the association's business of marketing the produce of its members, and any charge made for such trucking services is subject to tax. See Rev. Rul. 55-751, page 27."

3. Transportation tax applies to hauling charges paid by member of mutual cartage association. (Rev. Rul. 55-751; I.R.B. 1955-52, 27)

> "A mutual cartage association, which was organized as a separate legal entity and is being operated for the purpose of furnishing trucking services to its members in the operation of their separate businesses and makes a charge for such services, is a 'person engaged in the business of transporting property for hire' within the meaning of section 4272(a) of the Internal Revenue Code of 1954, even though the charges to the members cover only the actual cost of operating the trucks.

"Advice has been requested whether a mutual cartage association organized and operated for the purpose of furnishing a trucking service to its members in the operation of their separate businesses, where the amounts charged the members cover only the actual cost of operating the trucks, is a 'person engaged in the business of transporting property for hire' within the meaning of section 4272(a) of the Internal Revenue Code of 1954.

"In order to reduce the expense of transporting their merchandise and provisions individually from a warehouse to their respective stores, a number of independent retail merchants formed a mutual cartage association for their joint benefit and service. The association was organized as a separate legal entity under the laws of the state in which it now operates. It purchased a tractor and trailer, the initial cost of which was borne equally by the members. The operating expenses are paid by the members on a prorata basis. The amount charged each member for the trucking services furnished to him is determined by the hundredweight of the merchandise delivered to his store and the hauling distance from the warehouse to the store. The association hauls for members only and all of its acticities are confined to one state. The trucking service for members is its only business activity.

"Section 4271(a) of the Code imposes a tax upon the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water or air from one point in the United States to another. Under the provisions of section 4272(a) of the Code, the tax applies only to amounts paid to a person engaged in the business of transporting property for hire.

"Section 143.1(b) of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954-2, 47, defines the term 'person engaged in the business of transporting property for hire' to include a common carrier, contract carrier, local moving or drayage concern, freight forwarder, express company, or other person transporting property for hire wholly or in part by rail,

motor vehicle, water, or air. The term 'transportation' is defined in section 143.1(d) of Regulations 113 to mean the movement of property by a person engaged in the business of transporting property for hire, including interstate, intrastate, and intracity or other local movements.

"Section 7701(a)(1) of the Code defines the term 'person' to mean and include an individual, a trust, estate, partnership, association, company or corporation.

"It is held that since the association was organized as a separate entity and is being operated for the purpose of furnishing a trucking service for which it receives remuneration, and since the transportation service furnished to its members is not incidental to any other business activity in which the association is engaged, it is a 'person engaged in the business of transporting property for hire' within the meaning of section 4272(a) of the Code. Accordingly, the tax applies to the charges made by the association to its members for the transportation of their merchandise and provisions from the warehouse to their respective stores, even though such charges cover only the actual cost of operating the tractor and trailer. See Rev. Rul. 55-752, below."